

AREQUIPA

loses millions in tax revenue



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AREQUIPA loses millions in tax revenue

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Arequipa loses millions in tax revenue

Sunat expects a ruling in favor and demands to the company for S/ 800 millions of impaid royalties between 2006 and 2011

Arequipa is a copper producing region. For each S/ 100 in mineral extraction, S/ 64 come from copper; which is why mining is said to play a significant role in Arequipa's economy. Driven by the expansion projects of Sociedad Minera Cerro Verde (SMCV).

Arequipa is the region that received the most mining investment in recent years. According to the Project portfolio updated to January 2017¹, US\$ 5 billion will be

invested, representing 10% of the total investment expected for the whole country.

SMCV is a company dedicated to the exploration, extraction, production and commercialization of copper from the mines of the Cerro Verde I, II and III mining concession. This concession covers an area of 20,825 hectares and contributes 99% of copper production in the region, hence its importance in the revenues received by the region.

1. <http://www.minem.gob.pe/minem/archivos/file/Minería/INVERSION/2017/CARTERA01-2017-pdf>



Its main shareholder is Cyprus Climax Metals Company, which to date belongs to the Freeport-McMoRan Copper & Gold

Inc. (FCX)² economic group, after it acquired Phelps Dodge Corporation (PD) for US\$ 25.891 million on March 19, 2007.

Table 1: Shareholders - Sociedad Minera Cerro Verde

SHAREHOLDERS	PARTICIPATION
Cyprus Climax Metals Company / Freeport-McMoRan Copper & Gold Inc.	53.56%
SMM Cerro Verde Netherlands B.V.*	21.00%
Compañía de Minas Buenaventura S.A.A.	18.50%
Others	6.94%
TOTAL	100.00%

Source: Sociedad Minera Cerro Verde.

* Subsidiary of Sumitomo Metal Mining Company.

Increase in Cerro Verde's production has not translated into more canon for Arequipa

Sociedad Minera Cerro Verde has had and will continue to represent a significant share of Arequipa's mining production. The evolution of its production shows three phases, of which the second (starting in 2007) and the third (starting in 2016) mark significant productive leaps achieved with heavy investments.

Between 2004 and 2007 the company re-invested profits for approx. US\$ 800 million for the construction of the Primary Sulfide Mineralization Project, free of Income Tax (IT), which allowed it to save US\$ 240 million in taxes. The use of this tax benefit meant that Arequipa did not receive US\$ 140 million from mining canon.

2. FCX is an American company that is dedicated to exploration, development and processing of copper, gold, silver and molybdenum in Indonesia, USA, Peru, Chile and Congo.

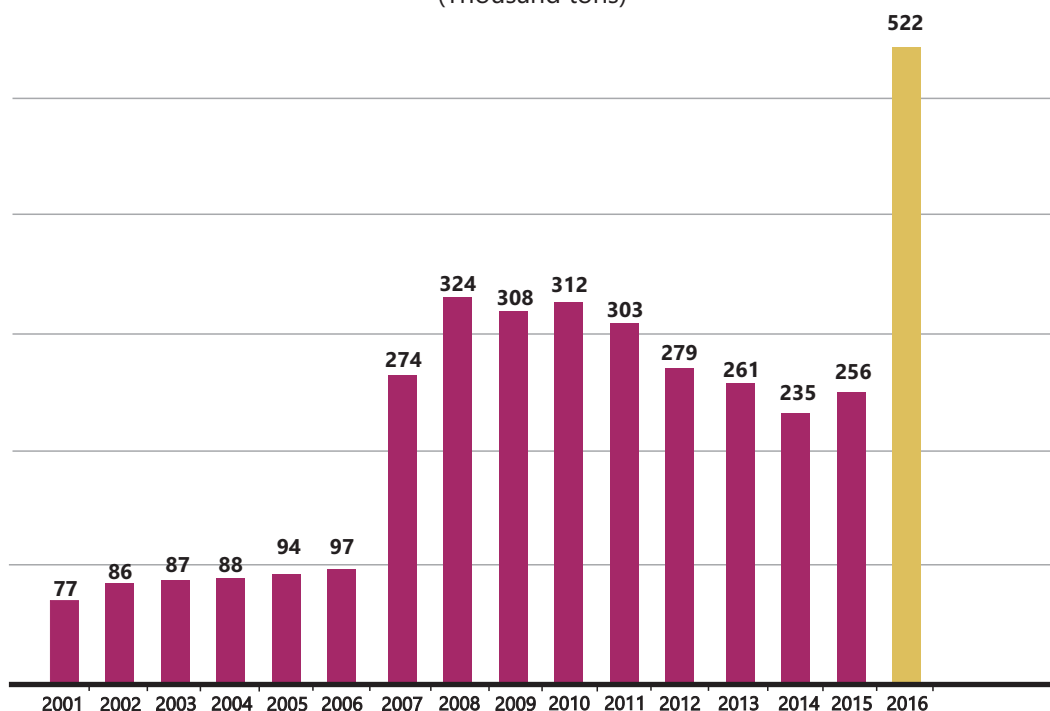
The two projects that allow the productive expansion of the company are: Primary Sulfide Mineralization Project, whose production started in 2006 with an investment of US\$ 900 million, and the Cerro Verde Expansion project, ten years later (2016), which implied an investment of approx. US\$ 5 billion.

This way, Cerro Verde tripled its production from an average of 90 thousand tons a year from 2001 to 2006, to 285 thousand tons between 2007 and 2015. Latter, with Cerro Verde's expansion project, production rose from 256 thousand tons of copper in 2015

"Between 2004 and 2007, income reinvestment, free of income tax (IT), allowed Cerro Verde to save US\$ 240 million in taxes, due to which, Arequipa stopped receiving US\$ 140 million per mining canon".

to 522 thousand tons of copper in 2016. Despite this production increase, the amount of mining canon received by the department fell sharply.

Figure 1: Cerro Verde's copper production, 2001-2016
(Thousand tons)



Source: Ministry of Energy and Mines.
Graph: Grupo Propuesta Ciudadana.

Tax policies only favored mining companies

"Sociedad Minera Cerro Verde is the only company in Peru that has benefited from tax stability contracts for 30 years for a single mining unit".

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The company signed two tax stability contracts with the State, for a duration of fifteen years each. The first, for the Leaching Plant Project (January 1998) until December 2013 and sought to stabilize the tax benefits granted by Alberto Fujimori's government. The second, for the Cerro Verde Expansion project (signed in July 2012, but became valid in January 2014 and goes until December 2028) that stabilizes the tax scheme defined at the beginning of Ollanta Humala's government.

During the 18 years of Cerro Verde's productive activity (1998-2016) there have been three changes in the tax policy for the mining sector in our country. In 2004, the Mining Royalties Act was enacted. In 2011, the Special Duty (Gravamen) on Mining and the Special Tax on Mining were created, together with a change in the calculation base of the mining royalties. Finally, in 2014, the IT rate decreased from 30% to 28% and the tax on dividends' rate increased from 4% to 6%.

Thanks to the first legal stability contract signed in 1998, Cerro Verde decided not to



pay mining royalties for the Primary Sulfide Mineralization project whose production started in 2006. However, this decision was not shared by the National Tax Administration (Sunat), for whom this project was not included in the company's legal stability contract; therefore, it had to pay the amount of mining royalties corresponding to the period between 2006 and 2011, which would amount to S/ 800 million.

The company did not hesitate to submit appeals to the Fiscal Court, Arequipa's Judicial System and the Supreme Court in Lima, obtaining until now unfavorable results, so that the debt would have to be



paid. Meanwhile, the company has made payments "under protest"³ for mining royalties: US\$ 39 million in 2014, US\$ 64 million in 2015 and US\$ 96 million in 2016; which make a total of US\$ 199 million paid.

According to estimates by Grupo Propuesta Ciudadana (GPC), between 2006 and 2011, Cerro Verde did not pay US\$ 330 million in royalties for the Primary Sulfide Mineralization project. According to estimates of the company itself, for the period between 2006 and 2013, the amount would be US\$ 540 million.

In 2006, Cerro Verde was one of the signatory companies of the Mining Program of Solidarity with the People (PMSP), negotiated between the mining guild and the government of Alan García, who did not fulfill his promise to apply a tax to the extraordinary profits of the mining sector. Its contribution was S/ 442 million, which were destined to finance two important projects: Distribution, Expansion and Improvement of the Water

System of Metropolitan Arequipa, and a Wastewater Treatment Plant.

If we compare the amount estimated by GPC (US\$ 330 million) and what the company contributed under the PMSP for the same period (2006 and 2011), which amounted to S/ 420 million, we find that the first amount significantly exceeds the second.

In the financial statements of Cerro Verde as of December 31, 2016, p. 27, states that "... the Company estimates that the total exposure associated with mining royalties for the period December 2006 to December 2013, including accrued interest and penalties, amounts to US\$ 544 million (at the closing exchange rate of December 2016)". Therefore, if the Supreme Court rules against the company, and taking into account the payments made between 2014 and 2016, Cerro Verde would have a debt to the Peruvian State for US\$ 345 million in unpaid royalties.

"According to estimates by GPC, between 2006 and 2011, Cerro Verde did not pay US\$ 330 million in royalties. According to estimates of the company, for the period between 2006-2013, the amount would be US\$ 544 million".

3. These are payments in advance made to protect the Company from the accumulation of interests and late fees in case it loses the legal controversy.

The years of mining boom were not used to increase tax collection

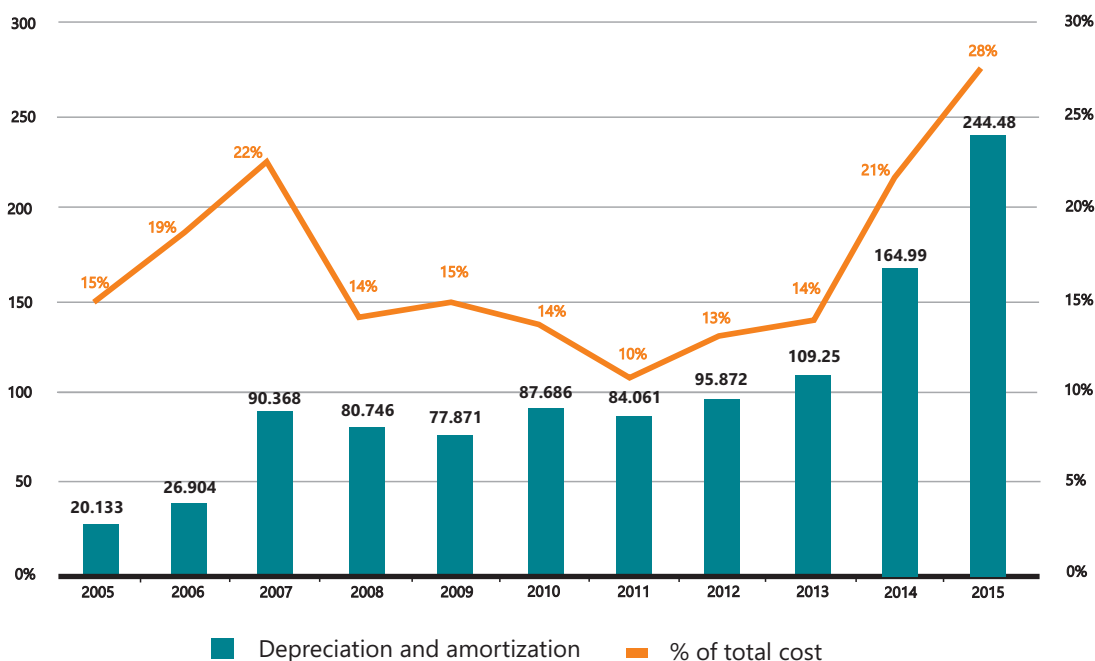
In the period between 2007-2014, Cerro Verde represented, on average, 90% of the third category IT generated by mining companies in the Arequipa region. This changed dramatically in 2015 when its contribution fell to a minimum.

"Between 2005 and 2012, when mining companies experienced a booming context, Cerro Verde earned net profits totaling US\$ 5,860 million".

Between 2005 and 2012, when mining companies experienced years of prosperity,

Figure 2: Depreciation and amortization: gross amount and percentage of sales cost. 2005-2015

(In million dollars and percentage)



Source: Financial statements Sociedad Minera Cerro Verde.

Figure by Grupo Propuesta Ciudadana.

Cerro Verde obtained extraordinary profits—with a ratio between net profits / total income that varied between 37% and 61.7%—that totaled US\$ 5.86 billion of net profits.

By 2015, this situation changed as net profits fell sharply due to the combination of two factors: lower prices and higher sales cost. In addition, the increase in depreciation and amortization expenses, and financial costs (loss due to exchange rate differences), also had an impact. Furthermore, the existence of tax planning practices by the company cannot be ruled out. This situation brought drastic consequences to the budget of the regional government and the municipalities in 2016.



One of the benefits used by SMCV was the re-investment of profits, which between 2004 and 2007 allowed it to access a US \$ 240 million tax credit for the construction of the Primary Sulfide Mineralization project. In addition to the exemption from the payment of mining royalties until 2014, since it had signed a tax stability contract.

Canon transfer plummet after the end of the syper cycle

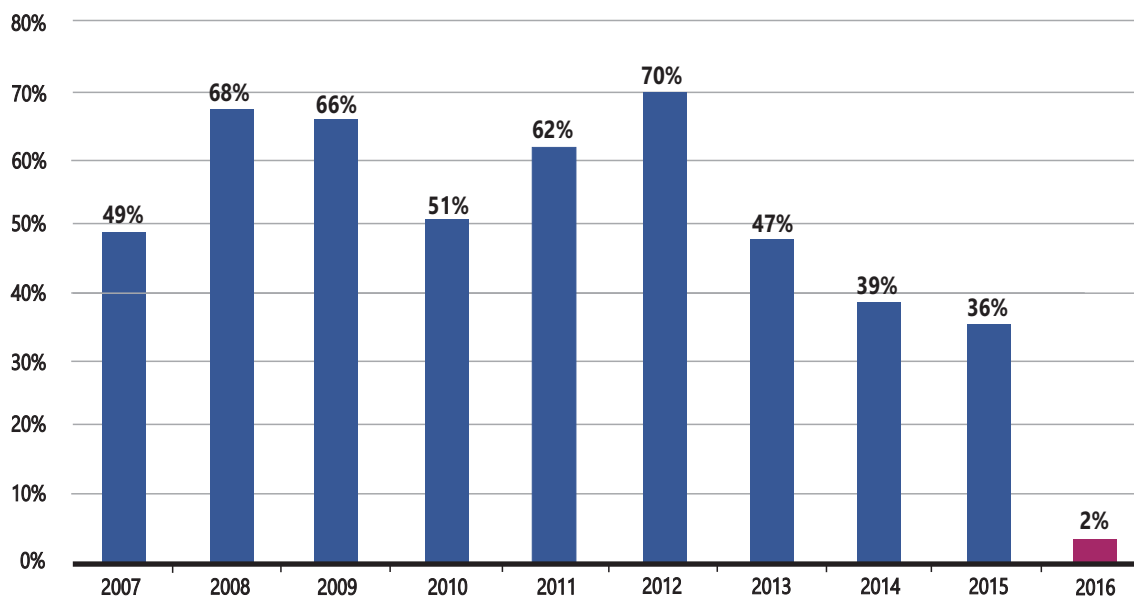
According to the Economic Transparency Portal of the MEF, between 2007 and 2012, the importance of mining canon in total transfers from the national government to the Arequipa Region was, on average, above 60%, approaching 70% between 2008-2009. From 2013 onwards, this percentage fell to an average of 40%, due to the fall in revenues from mining canon. By 2016, the figure plummets to 2%.

For the next few years, GPC warns that the sharp increase in Cerro Verde's production and sales will not result in substantial improvements in the amount of IT declared, and therefore in mining canon revenues, at least until 2019 or 2020, since the company has been making use of the "accelerated depreciation". benefit.⁴

4. With this benefit, companies have the right to depreciate their investments at a rate of 20% per year. This operation reduces the amount of money the company pays for income tax, which affects the mining canon transfers.

"The sharp increase in Cerro Verde's production and sales will not result in improvements in the mining revenues for Arequipa, at least until 2019 or 2020".

Figure 3: The Regional Government and municipalities in Arequipa: the importance of mining canon in total transfers from the National Government, 2007-2016
(In percentages)



Source: Economic Transparency Portal (Ministry of Economy and Finance - MEF.
Figure by Grupo Propuesta Ciudadana.

Some proposals

- Regulate the litigation of company tax tax debts.
- Change the base of the calculation of the mining royalties and return to the scheme based on the value of the ore concentrate.
- Greater transparency on the determination of the tax base. In this perspective, tax secrecy should be lifted for companies that exploit non-renewable natural resources.
- Eliminate the unjustified tax benefits for large mining companies and other sectors such as agroexport, education and banking and finance.

foto: larepublica.pe



foto: rpp.pe



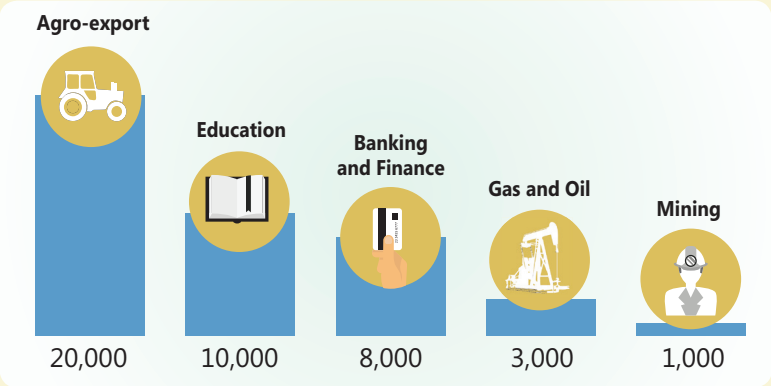
Figures of tax injustice in Peru

► Tax Benefits for Big Companies

They are tax breaks and incentives established in the 90's during Fujimori's government.

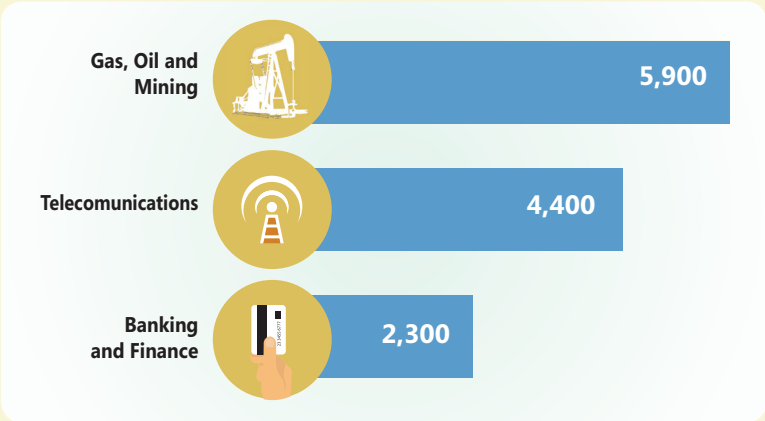
In the last 10 years, the state did not collect S/ 93 billion because of 78 tax benefits. The sectors that benefited the most are the following:

TAX BENEFITS FOR BIG COMPANIES
(In millions of S/)



► Largest Tax Debtors of SUNAT by sector

There are 50 influential companies that owe S/ 15 billion to SUNAT. The list is led by the following sectors:

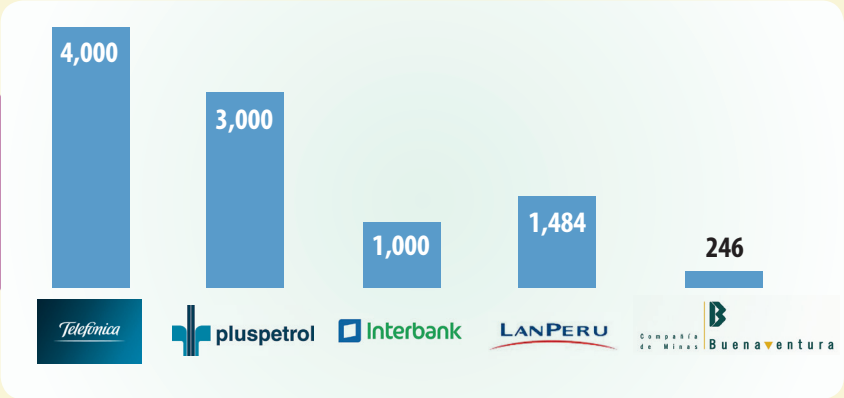


LARGEST TAX DEBTORS OF
SUNAT
(In millions of S/)

► Largest tax debtors of SUNAT by name

The largest companies that owe SUNAT and, therefore, the state are the following:

COMPANIES THAT OWE THE MOST OF
SUNAT
(In millions of S/)



Big companies use the practice of appealing and judicializing their debts with the state for many years.